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CREDIT.

BEING A PAPER READ AT

The National Liberal Club Political Economy Circle.

BY

HENRY DUNNING MACLEOD, M.A.,

OF THE INNER TEMPLE, BARRISTER-AT-LAW;

*Selected by the Royal Commissioners for the Digest of the Law to prepare the
Digest of the Law of Bills of Exchange, Bank Notes, &c.;*

*Honorary Member of the Juridical Society of Palermo, and of the
Sicilian Society of Political Economy;*

*Corresponding Member of the Société d'Economie Politique of Paris, and of
the Royal Academy of Jurisprudence and Legislation of Madrid.*

PRINTED FOR PRIVATE CIRCULATION ONLY.

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WORKS IN ECONOMICS

BY THE AUTHOR.

ELEMENTS OF POLITICAL ECONOMY. 1858.

A DICTIONARY OF POLITICAL ECONOMY, Biographical, Bibliographical, Historical, and Practical. Vol. I. 1862.

THE PRINCIPLES OF ECONOMICAL PHILOSOPHY (being the Second Edition of the Elements of Political Economy). 2 Vols. 1872-75.

LECTURES ON CREDIT AND BANKING: delivered at the request of the Council of the Institute of Bankers in Scotland. 1 Vol. 1882.

. *The above Works are out of Print.*

THE THEORY AND PRACTICE OF BANKING. 2 Vols. Fifth Edition. 1892-93. Vol. I., Price 12s.; Vol. II., Price 14s.

THE ELEMENTS OF ECONOMICS (being the Third Edition of the Elements of Political Economy). 2 Vols. 1881-86. Price 7s. 6d. each Vol.

THE ELEMENTS OF BANKING. 1 Vol. Thirteenth Edition. Price 3s. 6d.

ECONOMICS FOR BEGINNERS. 1 Vol. Fifth Edition. Price 2s. 6d.

THE THEORY OF CREDIT. Second Edition. Vol. I.; Vol. II., Part I.; Vol. II., Part II. Price 10s. net, each.

BIMETALISM. 1 Vol. Second Edition. Price 5s. net. 1894.

THE HISTORY OF ECONOMICS. 1 Vol. Price 16s. 1896.

CREDIT.

BY H. DUNNING MACLEOD, M.A.,

Read 17th November, 1897.

ARTHUR COHEN, Esq., Q.C., IN THE CHAIR.

—o—

I CAN scarcely express the feeling of anxiety which weighs upon me in acceding to your kind request to address to you some observations on the colossal and abstruse subject of Credit.

I need hardly say that in the following remarks it would be wholly impossible to go into the entire Theory of Credit, the most profound, subtle, and complex branch of Mercantile Law. To do that would require a course of lectures extending over weeks and weeks. From the necessity of the case my remarks can only be scrappy and discursive. The time at my disposal only permits me to draw your attention to some salient points, in the hope, perhaps futile, that, if there be any present who wish to take up this branch of economics seriously, it may stimulate them to further inquiry.

Vastness of the
Subject.

But I may mention that I have published a systematic treatise on Credit, under the title of "The Theory of Credit." In this work I have carefully culled the fundamental Concepts and Principles of Credit from the Pandects and the great Continental treatises on Jurisprudence, which on this subject are infinitely superior to our own. I may further state that the principles of Credit set forth in this work were entirely approved of by the Law Digest Commissioners; and that, in the case of *Goodwin v. Robarts*, the greatest mercantile case in our history, the Court of Exchequer Chamber unanimously decided that they were strictly accurate in every particular; and they further recommended that they should be put into a form calculated for popular circulation, which is exactly what I have done. Since

Author's work on "The
Theory of Credit."

Goodwin v. Robarts.

then, they have, by statute, become the law of the land. And, side by side with the theoretical Principles of Credit, I have exhibited their practical application in Mercantile Credit, the colossal business of Banking, and the Foreign Exchanges.

References.

But, as the doctrines which I shall touch upon presently, though every Mercantile Lawyer has them at his fingers' ends, may seem somewhat novel or even startling to lay readers, I have given references to the places in my work where they may be found detailed more at length and more completely.

Definitions.

But here we are confronted with a difficulty of stupendous magnitude. As you are aware, the physical sciences are founded upon Definitions which in many cases were only settled after long and vehement controversies. At last, however, scientific men came to an agreement; and upon these foundations the majestic structures of the physical sciences have been erected. But the early economists were so intent upon sweeping away antiquated obstructions, and on a magnificent series of economic measures which have, since then, been carried into effect in this country, that they never bestowed any attention on settling its fundamental ideas and concepts by the same principles that the physical philosophers have done. Furthermore, they have never come to any settled agreement as to its Definitions. Now, how can people argue if they radically differ as to the meaning of the words they use? When people give radically different meanings to the same word they do not speak a common language. It is, therefore, necessary to examine shortly the meanings of the words which are necessarily employed in the following remarks.

Wealth.

In inviting you to consider the true definition of Wealth I trust that you will not think that I am going to amuse you with vain logomachy or curious speculation. On the contrary, this word is not only the basis of a great science, but there is, probably, none which has so seriously influenced the history of the world and the welfare of nations, according to the meaning given to it at various periods.

J. B. Say.

For many centuries the legislation of every country in Europe was moulded by the meaning of the word Wealth. The

eminent French Economist, J. B. Say, says that during the two centuries preceding his time fifty years were spent in wars, directly originating out of the meaning given to this word.

Another Economist, Storch, says:

Storch.

—“It is no exaggeration to say that there are few political errors which have produced more mischief than the Mercantile System. . . . It has made each nation regard the welfare of its neighbours as incompatible with its own; hence their reciprocal desire of injuring and impoverishing one another, and hence that spirit of commercial rivalry which has been the immediate and remote cause of the greater number of modern wars. . . . In short, where it has been the least injurious it has retarded the progress of national prosperity: everywhere else it has deluged the earth with blood, and has depopulated and ruined some of those countries whose power and opulence it was supposed it would carry to the highest pitch.”

So Whately says:—“It is well if the ambiguities of this word had

Whately.

done no more than puzzle philosophers. . . . It has for centuries done more, and perhaps for centuries to come will do more, to retard the progress of Europe than all other causes put together.”

Now, certainly, we may be very sure that no wars in future times will ever again be caused by the

Mercantilism and Socialism.

meaning of the word Wealth. But for all that is all danger over? Far from it. On the contrary, if possible, we are menaced with a more terrible danger still. Because that dread spectre of Socialism, which now threatens civil war and revolution to every country on the Continent, and which seems unhappily to be gaining ground in this country, is entirely based, as the Socialists themselves say, on the doctrines of Wealth put forward by Adam Smith and Ricardo. These considerations, which are nothing but the literal truth, show you the gravity and the importance of the inquiry to which I invite you.

Ancient writers unanimously held that Exchangeability is the sole essence and principle of Wealth—

Exchangeability and Wealth.

that everything which can be bought and sold or exchanged is Wealth, no matter what its nature or its

Aristotle. form may be. Aristotle says:—

“*Χρήματα δὲ λέγομεν πάντα ὅσων ἡ ἀξία νομίσματι μετρεῖται*”—“*By the term Wealth we mean all things whose value can be measured in money.*” Thus, Aristotle, who laid the foundation of the Science of Economics, at the very first laid down the definition of Wealth which has been the subject of controversy in modern times.

Ulpian. Ulpian, the eminent Roman jurist, says:—“*Ea enim Res est quæ emi et*

venire potest”—“For that is Wealth which can be bought and sold.” The only Economist in modern times who has exactly hit the truth is Mill, who says:—“Everything, therefore, forms part of Wealth which has a Power of Purchasing.”

Definition of Wealth. Here we have a perfectly good

General Concept, or Definition, fitted to form the basis of a great Science. It is a Concept as wide and general as the dynamical definition of Force. That single sentence of Aristotle's is the germ out of which the whole Science of Economics is to be evolved; just as the huge oak tree is developed out of the tiny acorn.

Categories of Wealth. Having then adopted Exchangeability, or the capability of being bought and sold, as the sole essence and principle of Wealth, we have next to determine how many orders or species of quantities there are which satisfy this Definition. There are, of course, first material commodities, about which I need say nothing.

Socrates on Wealth. There is an ancient anonymous

dialogue termed the *Eryxias* which is the earliest that I am aware of on the subject of Economics. The highest authorities on the subject inform me that it was probably written at the close of the fourth century B.C. Socrates is made to show that, adopting Exchangeability as the criterion of Wealth, money is only Wealth when and where it is exchangeable; when and where it is not exchangeable it ceases to be Wealth. The only use of money is to enable us to obtain what we require. Then he says that there are persons who gain their living by giving instruction in the various sciences. These persons are able to obtain what they require by giving instruction in just the same way as they could with money. Therefore he says the sciences are Wealth—*αἱ ἐπιστήμαι χρήματα οὖσαι*—and that those who possess them are richer—*πλουσιώτεροί εἰσι*.

Now one of the great services Adam Smith did to Economics was to break through the narrow dogmatism of the first school (who refused to admit that anything was Wealth except material commodities) and include Labour as Wealth, and as a marketable commodity, and discuss the laws which govern the value of Labour. But this ancient dialogue anticipated Smith by 2,100 years. Thus this dialogue established the fact that Personal Qualities in the form of Labour have purchasing power and are Wealth. And modern Economists recognize the industrial capacities of the people as national Wealth.

Personal Qualities as
Wealth.

But Personal Qualities may be used as Purchasing Power in another form than that of Labour. If a merchant enjoys good "Credit," he may purchase goods, not with money, but with a Promise to pay money at a future time. Hence a merchant's Credit is Purchasing Power exactly as money is. The merchant's Purchasing Power is his MONEY and his CREDIT. They are both therefore equally Wealth by Mill's own definition. When a merchant purchases goods with his Credit, his Credit is valued as money exactly as his Labour may be. Hence, by Aristotle's definition, which is now universally accepted, a merchant's Personal Credit is Wealth.

Labour and Credit.

Demosthenes was the first to perceive and declare that Credit is Wealth and Capital. He says:—"δυοῖν ἀγαθοῖν ὄντων πλούτου τε καὶ πρὸς ἅπαντας πιστεῦεσθαι μείζον ἔστι τὸ τῆς πίστεως ὑπαρχον ἡμῖν."—"There being two kinds of Wealth—Money and General Credit—the greater is Credit, and we have it." So again:—"εἰ δὲ τοῦτο ἀγνοεῖς ὅτι πίστις, ἀφορμὴ τῶν πασῶν ἔστι μέγιστη πρὸς χρηματισμόν, πᾶν ἂν ἀγνοήσεις"—"If you were ignorant of this—that Credit is the greatest Capital of all towards the acquisition of Wealth, you would be utterly ignorant." Thus Demosthenes shows that Personal Credit is ἀγαθὰ—WEALTH, Property, Goods and Chattels—and ἀφορμή, or CAPITAL. Thus, though Personal Credit, like Labour, can neither be seen, nor handled, nor touched, yet it can be bought and sold or exchanged, its Value can be measured in money—it is Purchasing Power—and therefore it is Wealth. Adam Smith declares that a man's Labour is his most sacred

Demosthenes.

Credit is Wealth.

possession, of which no person has the right to despoil him: so to all merchants, bankers, and traders, their Credit is their most sacred property of which no person has the right falsely to despoil them.

The first school of Economists denied the title of Wealth to Credit as they did to Labour; but on this point the contemporary mercantile Economists were dead against them, and included Credit under the term Wealth. Smith, Say and Mill all do the same.

Hence the Personal Credit of all Bankers, Merchants and Traders is an integral and colossal portion of the National Wealth—just as the industrial faculties of all the people are. So also the Credit of the State, by which it can purchase money by giving in exchange for it the right to demand a series of payments out of its future income, is National Wealth.

Thus Demosthenes anticipated more than two thousand years ago the doctrines now admitted by all Economists (p. 16).

Abstract Rights as Wealth.

But there is yet another or a Third order of Quantities which can be bought and sold, or exchanged, and whose Value can be measured in money: and these are Abstract Rights of various sorts—Rights and Rights of action such as Debts, the Funds, Shares in Commercial Companies, Copyrights, Patents, &c.

Now in the Pandects of Justinian, which are the great Code or Digest of Roman Law, it is laid down as a fundamental general rule:—“*Pecuniæ nomine non solum numerata pecunia, sed omnes Res tam soli quam mobiles, et tam corpora quam jura continentur*”—“Under the term Wealth, not only ready money, but all things, both immovable and movable, both corporeal things and Rights are included.” Ulpian says:—“*Nomina eorum qui sub conditione vel in diem debent et emere et vendere solemus. Ea enim Res est quæ emi et venire potest*”—“We are accustomed to buy and sell Debts payable at a certain event or on a certain day. For that is Wealth which can be bought and sold.” So also:—“*Æque Bonis adnumerabitur si quid est in actionibus*”—“Rights of action are properly reckoned as Goods.” And also:—“*Rei appellatione et Causæ et Jura continentur*”—“Under the term Wealth, both Rights and Rights of Action are included.”

The same doctrines are repeated in the Basilica, which was the great revised Code of the ninth and tenth centuries.

Thus Abstract Rights of many various sorts, including Rights of Action, which in Law, Commerce and Economics are termed Credits or Debts, are expressly included under the terms *Pecunia* (Wealth), *Res* (Property), *Bona* (Goods or Chattels) and *Merx* (Merchandise) in Roman Law. This class of property is termed *Res Incorporales* in Roman Law, οὐσία ἀφάνης in Greek Law, and Incorporeal Wealth in English Law.

Now these Abstract Rights can neither in that form be seen, nor **Invisible and Intangible Wealth.** handled, nor touched; but they can be bought and sold, or exchanged; their value can be measured in money. They can be transferred from one person to another as easily as any material chattel. Therefore, they satisfy Aristotle's definition of Wealth. They possess the Quality of Exchangeability, and therefore, by the fundamental laws of Natural Philosophy, these Abstract Rights are Wealth.

But these Abstract Rights may be written down and recorded on some **Documentary Credit.** material such as parchment or paper, and then they become material commodities and transferable from hand to hand just like money or any other material chattels.

Thus we see that there are three orders of Economic or Exchangeable **Three Orders of Economic Quantities.** Quantities which can be bought and sold, or exchanged, or whose value can be measured in money—(1) Material things; (2) Personal Qualities both in the form of Labour and Credit; and (3) Abstract Rights. Taking Money as representing all material things; Labour as representing all forms of personal energy; and Credit as representing all Abstract Rights, we may say that Wealth is of three forms: Money, Labour, and Credit. And there are no Exchangeable Quantities which are not one of these three forms. Hence the complete Science of Economics, or Commerce, consists of three departments: (1) the commerce in material things; (2) the commerce in labour; and (3) the commerce in Abstract Rights. These three orders of quantities can be exchanged in six different ways, and these six different kinds of exchange comprehend the whole science of

commerce, or Economics, in all its different forms and varieties.

**Radical Defects in
Current Economics.**

I now have to draw your attention to the radical and vital defect of all the current works on Economics, which renders them utterly useless for the great Economic problems which are so important at the present day.

Suppose that a person held, as it is termed, £500,000 in the Funds, an equal quantity of Bank of England Stock, an equal amount in shares of the several great London and other Joint Stock Banks, also in Railway Debentures and Municipal Stock, and many other properties of a similar nature, you would assuredly say that he was a "wealthy" man. Now this class of property is nothing but a mass of Abstract Rights; they are no title to any specific money, or other commodity. But their value may be estimated in money: they are bought and sold to the amount of scores of millions every day. Property of this class is dealt with on the Stock Exchange to the amount of £8,000,000,000 annually. This class of property possesses the attribute of exchangeability. Therefore it is Wealth. In this great mercantile country this class of property far exceeds all others, except perhaps the land. That this is Wealth nobody would venture to deny. But how it is to be classed is quite a different question. And this is the serious difficulty I have in addressing a lay audience, such as the majority of you are, I presume. Economics is now universally admitted to be a physical science, and those who are most deeply versed in the physical sciences, can apprehend the subtleties and perplexities of Economics. In every physical science there are Positive Quantities and Negative Quantities, and I have shown that this class of property is exactly analogous to Negative Quantities in mathematics and physics.

**Credit as Wealth
ignored by Economists.**

In Adam Smith's time, this class of property was very minute; but, since his day, it has been increasing at a much more rapid rate than material property. And yet though it has been growing under the eyes of economists, except in a few small items, it is utterly ignored by them. Again, although at the present day this is the most gigantic department of commerce, no economist hitherto ever made the slightest attempt to set forth the juridical principles, or the organization of the

commerce of this class of property. Now, for writers on economics who treat of Wealth and Commerce to omit the largest class of property and the most extensive department of commerce from their works, is just as absurd as for a writer on mathematics to omit all notice of the Differential Calculus and its developments ; or for a writer on machinery to omit all notice of the Steam Engine.

It is this department of Economics—the commerce in Rights and Rights of Action—that I have made my own, and by so doing I have done exactly in economics what mathematicians and physicists have done who made Negative Quantities integral parts of their various sciences. By this means I have doubled the extent of the Science as treated in the common books, and I have expanded Economics to embrace Universal Commerce in all its various forms.

To understand the true nature of Money and Credit we must revert to the original conception of Economics as held by its founders. They and all their contemporaries, though differing on some important points, held that Economics is the Science of Exchanges, or of Commerce. And the most advanced Economists have now come back to that concept as the only one upon which it can be made a positive and definite science, precisely analogous to one of the standard physical sciences.

The Economists then held that an Exchange consisted in the exchange of a satisfaction for a satisfaction, for in this case only was the transaction completed. When a commodity was sold for money they said that was not a satisfaction: if you receive money in payment you can neither eat it, nor drink it, nor clothe yourself with it. Its only use is to enable you to get anything you want from someone else. When you are paid in money the transaction is not completed; and it is not completed until you have obtained a satisfaction. They therefore termed a payment in money a demi-exchange. But as it was only the means of completing an exchange they termed it the MEDIUM OF EXCHANGE. But they also called a Sale, Circulation. When a person buys goods with Money he causes them to circulate. Hence Money was also called the CIRCULATING MEDIUM.

Money and Credit.

**Nature of
Exchange.**

**Credit and
Circulation of Goods.**

But if a merchant buys goods with Credit he circulates goods exactly in the same way as if he had bought them with Money; and this Credit affects prices exactly in the same way as Money does. Therefore the Circulating Medium consists of Money and Credit in all its forms, both written and unwritten.

A whole series of writers, Aristotle, Bishop Berkeley, the Economists, Adam Smith, Thornton, Edmund Burke, Bastiat, Mill, and Jurists, have all seen that Money is only the highest and most general form of Credit. Their doctrines are far too long to cite here, but you may see them set forth at length in my *Theory of Credit*, p. 75.

**Money the most General
Form of Credit.**

Daniel Webster, the great American Jurist and Statesman, says:—"Credit is to Money what Money is to goods." That is, Money is an order for goods, and credit is an order for Money. That is, each of them is a separate and independent exchangeable quantity. It is a very common error among literary writers that Credit is a title for some specific money. But that is a vital error. A Credit is not a title to any specific money; it is only a Right against some person to demand money in exchange for it.

CREDIT.

The Word Credit.

I must now say a few words about the word Credit. CREDITUM is one of a class of words which in classical Latin means a material commodity, but which in the technical language of modern Law and Economics means nothing but a Right of Action.

In popular language, a merchant's Credit means the general estimation he is held in, so that he is able to buy goods or other things by giving his Promise to pay at a future time, instead of paying actual cash.

But such Credit does not enter into Economics until he actually exercises this power, and makes a purchase by giving a promise to pay at a future, instead of paying hard cash.

When he does so, the goods bought on Credit become his absolute property exactly as if he had paid for them in money, and he can dispose of them in any way he pleases

to his own advantage. His creditor, or the person from whom he has bought the goods, has lost all control over them. The Right of action to demand Money at a future time is equally Payment as money itself, and no Debt arises until the bill becomes due and payable. It is this Right of action which in Law and Economics is termed "a Credit."

It is somewhat unfortunate that in English the word Credit is used in two senses : (1) to denote the merchant's personal character, and (2) the Right of action which he creates and gives to purchase the goods. The French has two words to denote these different things. *Crédit* usually in French denotes the merchant's character, and the Right of action he creates is usually termed a *Créance*, though by no means uncommonly the word *Crédit* is also used by French writers to denote the Right of action. For my part I think that it would conduce to the clear apprehension of the subject always to keep these words separate. In English this cannot be hoped for. You must, therefore, understand that in Law and Economics "a Credit" means a right of action to demand a sum of money from a person. If you have a Credit in bank, it means that you have a Right of action against the banker to pay you a sum of money on demand. A person's creditors are those who have legal Rights against him to demand a sum of money from him.

French Usage.

Money and Credit then are essentially of the same nature ; but yet there is a material distinction between them. In Economics all Money is Credit but all Credit is not Money. No one can compel anyone else to sell him anything for Money or Credit. When then anyone has taken Money in exchange for anything, it is only Credit because he only takes it in the belief that he can exchange it for something else.

Distinction between Money and Credit.

But suppose that a sale has taken place, and that a Debt has been incurred thereby. Public policy requires that the Debtor should be able to compel the Creditor to accept something in discharge of his Debt. It would cause infinite misery if Creditors could arbitrarily refuse anything they pleased in payment and satisfaction of their Debts. Hence in all countries the Law declares that if a Debt *has been incurred*, the Debtor can compel the Creditor to accept some specific thing in payment of it.

Legal Tender.

Whatever that something is which a Debtor can compel a Creditor to accept in payment and discharge of a Debt *which has been incurred* is Money or Legal Tender. From this it follows that some things may be Money in some cases and not in others. In this country Gold coin is Money or Legal Tender, in all cases and to any amount. Silver is only Money, or Legal Tender to the amount of 40s. If a Creditor chooses to accept a payment in silver to a larger amount than 40s., it is entirely of his own free will.

Bank of England Notes. In England, as between the Public and the Bank of England, its Notes are nothing but Credit. The Bank cannot compel anyone to receive its Notes; and any holder of its Notes can compel the Bank to cash them on demand. Between private persons, a Bank Note for £5 is not Money, or Legal Tender, for that exact amount. But in all Debts above £5 Bank Notes are Money. In Scotland and Ireland Bank of England Notes are not Legal Tender in any case.

Other Bank Notes.

If two bankers issue Notes and an equal amount of them get into each other's hands, the Notes are Money, or Legal Tender, with respect to each other, by the principle of Compensation described below; and neither can demand money from the other.

If a banker holds a merchant's acceptance which has become due, and the merchant holds the banker's Notes to an equal amount, they are each Money or Legal Tender, with respect to each other, and neither party can demand actual cash from the other, and there are many other similar cases.

Debt.

I now come to the word Debt, of which very few people have any clear idea. The word *Debitum* is one of those words which, in classical Latin, mean a material commodity, but which, in juridical Latin and modern commerce, mean nothing but Rights and Duties.

In classical Latin, the word *Debitum* means the material commodity owed. This was my own idea of the matter, and I am happy to say that I was confirmed in it by Professor Nettleship, the great Oxford Latin scholar. But, in the progress of Jurisprudence, the word *Debitum* came to be used by the Roman Jurists as synonymous with *Obligatio*, which was the pure abstract

contract between Creditor and Debtor and therefore included both the Creditor's Right of action and the Debtor's Duty to pay. And that is the meaning of Obligation to the present day. But, in the process of time, though I cannot say when, but certainly by the eleventh century, the word *Debitum* split up into two parts. It came to be used separately and singly to denote the Creditor's Right of action and the Debtor's Duty to pay, and so it continues to the present day. Continental Jurists term the Creditor's Right to demand the active Debt, and the Debtor's Duty to pay the Passive Debt. But this custom has never obtained in England. In English Law and common usage the word "Debt" is used quite indiscriminately to denote both the Creditor's Right to Demand as well as the Debtor's Duty to pay. It is so used in our Statutes, in legal text-books, and in the common lay books, and it requires vigilance to discern in which sense it is used.

Thus you must please to observe that the words Credit and Debt (active) are used quite indiscriminately to mean the Creditor's Right to demand, and the word Debt (passive) means solely the Debtor's Duty to pay.

Most persons, I imagine, presume that Credits are only payable in money. But that is a great mistake.

Credit payable in
Services.

A Credit is the Right to compel a person to pay or *do* something. Hence large amounts of Credit are payable, not in any material substance, money or any other, but in Personal Services. In feudal times, Rents were payable, not only in money and in products of the earth, termed Rents in kind, but also in personal services; and such Rents were termed Rent Services.

A jaded legislator has taken shootings in the Highlands. On the 10th of August he goes to the railway station and pays four guineas, say, for a ticket to Inverness. The money he pays becomes the property of the company. In exchange for it he receives a ticket. That ticket is a Credit. It is a Bill payable in a railway journey to Inverness. A person goes to a post office and buys stamps. The money becomes the property of the post office. The stamps issued in exchange for it are Credit. They are bills payable in the carriage of a letter. A Fellow of the Zoological Society, in exchange for his subscription, receives an ivory. That ivory is a Credit. It is a bill payable in admissions to the gardens. A person wishes

to see Irving in Hamlet. He has perhaps to buy a ticket a fortnight in advance. That ticket is a Credit. It is a bill payable in seeing Irving in Hamlet. A College engages one of its members at a quarterly salary to give lectures to its students. The lecturer gives his lectures, and thus acquires a Right to demand his salary from the College. This Right of action is a Credit, or a Debt. A member of the University gives lessons to private students. The fee is paid either in advance or after the lessons are given. If the fee is paid in advance, the student acquires a Right of action, a Credit or a Debt, against his tutor to demand so much instruction. If the lessons are given first the tutor acquires a Right of action, a Credit or a Debt, to demand payment for his lessons. The master of a household engages servants and promises to pay their wages monthly or quarterly. The servant performs his term of service and then has acquired a Right to demand his wages; this Right of action is a Credit or a Debt. And so many other cases might be cited. It is sometimes proposed by light-hearted persons to abolish Credit. The answer is that society could not exist an hour without it.

I shall now make a few remarks
The Value of Land. on the Theory of the Value of Land, because that will throw a clear and steady light on the Theory of Credit.

Suppose we saw a piece of Land on which there were actually existing products of the value of £3,000. Suppose we wished to purchase that piece of Land. Would the owner of it be willing to sell it to us for £3,000? Most assuredly not. He would say that though there were only products of the value of £3,000 on the land in actual existence at the present time, yet that land would produce a similar amount of products to the end of time. He would say that we must purchase not only the right to the presently existing products of the land, but also the Right to the annual products of the land to the end of time, that is to an infinite series of future products which will only come into existence year by year.

But though the yearly products of the land will only come into existence at future intervals of time, the Right or Property to receive them when they do come into existence is PRESENT; and it may be bought and sold like any material chattel, such as a watch or a horse. That is to say, each of these annual products for ever has a PRESENT VALUE: and the purchase money of the land

is simply the Sum of the Present Values of this infinite series of future products.

Again, although this series of future products is infinite, a simple Algebraical formula shows that it has a finite limit, and that finite limit depends chiefly on the usual average Rate of Interest. When the usual rate of Interest is 3 per cent. the theoretical value of the land would be about 33 times its annual value. In the case above stated the value of the estate would be about £100,000.

Now when a purchaser has bought an estate in land, it may be said, **Credit of the Land.** without any very great metaphor, that it OWES him a series of annual payments for ever. Because he only bought it in the belief or expectation that it would yield these profits. Hence we may call the Right to receive the future profits of the land the CREDIT of the land. Thus the purchase of an estate in land is simply the purchase of a perpetual annuity.

The investigation of the Theory of the Value of Land demonstrates a **Money a Perpetual Annuity.** proposition of great importance in Economics. It is seen that the £100,000 to purchase the estate in land expected to produce £3,000 a year, is in reality the sum of the PRESENT VALUES of its future products for ever. But the same is evidently true of every sum of money: it is not only equal in value to a certain quantity of material goods, or to a certain quantity of services, but also to a PERPETUAL ANNUITY.

An Annuity is the Right to receive a series of future payments. The **What is an Annuity?** lowest form of an Annuity is the right to receive a single future payment such as a Bank Note, Cheque, or Bill of Exchange. The highest form is the Right to receive an infinite series of future payments such as the Land, or the Funds. And there may also be the Right to receive a limited number of future payments, intermediate between the other two, which is called a Terminable Annuity. Hence an Annuity or the Right to receive a series of future payments is an Economic Quantity which may be bought and sold, or exchanged, or whose value may be measured in money like any material chattel.

It is thus seen that Economics comprehends *three* great departments: (1) Material things; (2) Personal Qualities; (3) Abstract Rights or Annuities.

The first school of Economists endeavoured to restrict Economics to the first of these departments or material goods, and refused to take any notice of the other two. Adam Smith, J. B. Say and J. S. Mill have given much attention to the second; they have treated Labour as a marketable commodity, and so admitted the commerce in Labour as a department of Economics. They have also incidentally noticed the existence of some Abstract Rights, such as Bank Notes, Bills of Exchange, &c. But they never had the faintest notion of the great Juridical

The Juridical Theory of Credit. Theory of Credit, and they never made the slightest attempt to investigate the principles and mechanism of the great commerce in Rights and Rights of Action, which, at the present day, is by far the most extensive department of Commerce or Economics; and they never had any more notion of it than the first discoverers of a few small islands had of the huge Continent of America which lay behind them.

A Merchant an Economic Quantity. Now a merchant or any person exercising any profitable business or profession is an Economic Quantity exactly analogous to Land. Land has produced profits in the past and it has equal capacity to produce profits in the future. So a merchant or a professional man may have accumulated a quantity of Money, as the fruits of his skill, industry, and ability in the past. But, over and above his accumulated Money, he has the same skill, industry, and ability to earn profits in the future. And, of course, he has the Right, or Property, in these expected profits in the future.

And he may trade in two ways. He may trade with the Money he has already acquired, the profits of the past; or he may trade by purchasing goods by giving in exchange for them the Right, or Property, to demand payment at a future time out of the profits he expects to earn in the future.

Personal character used to trade in this way as Purchasing Power is termed Credit. And as we have seen that ANYTHING which has purchasing power is wealth, it follows that Money and Credit are equally wealth.

THE TRUE FUNCTION OF CREDIT.

Function of Credit. The true function of Credit is now apparent. It is a very common idea that Credit is the goods which are "lent," or the

transfer of them. But such ideas are wholly erroneous. In all cases whatever a Credit is the PRESENT RIGHT to a FUTURE PAYMENT. And the true function of Credit is to bring into commerce the Present Values of Future Profits.

When an estate in land is sold the Present Value of all its future is expressed and brought into Commerce by the money paid for it. The total amount of the Shares in any commercial company, banking, railway, insurance, or any other denotes the value of the existing property together with the total Present Value of their Future Profits. The money paid for the purchase of the goodwill of a business, a copyright, a practice, &c., is the Present Value of the Future Profits. So, when a merchant trades on "Credit," he brings into commerce the present value of a future profit.

Present Values of
Future Profits.

So, when a State contracts a loan for any public purpose, it buys the money, and gives as its price the Right to demand a series of payments out of the future income of the people. The same is true when municipal corporations and other public bodies contract loans. They buy the money by giving as its price the Right to demand a series of future payments out of the future incomes of their constituents. That is, they bring into commerce the Present Value of their Future Income.

State Loans.

So Credit in all its forms, and to whatever purpose it is applied, simply brings into commerce the Present Value of a Future Profit.

The famous French wit, Rivarol, well said—"Man conquers space by commerce and TIME by CREDIT."

Thus by the organization of Credit vast masses of Exchangeable Quantities are brought into commerce.

Organization of Credit.

Mr. Justice Byles says:—"This species of property (*i.e.*, Bills and Notes) is now in aggregate value inferior only to the land or funded debt of the Kingdom." If we include Credit in all its forms it exceeds many times the funded debt. Chancellor Kent says:—"As they serve the purposes of cash, facilitate commerce, and are the visible representatives of property they may be truly said to enlarge the Capital Stock of Wealth in circulation, as well as to increase the trade of the country."

Simple Example of the Use of Credit. As a simple and elementary example of the use of Credit, I may cite the following well known instance.

The States of Guernsey determined to build a meat market and voted £4,000 to defray the cost. They did not borrow actual money for the purpose. They saw that when the meat market was finished it would produce a sure future income. So the Government issued 4,000 cardboard tickets inscribed as "Guernsey Meat Market Notes" at £1 each, and they were accepted as legal currency by universal consent. With these notes they paid the contractor; and with them he paid his workmen, and all who supplied them with materials. They were freely taken by the tradesmen for goods, by landlords for rent, by the authorities for taxes. In due season, the Market was completed. The butchers' stalls, with some public rooms over them, were let for an annual rent of £400. At the expiration of the first year of this tenancy the States called in the first batch of these notes, numbered 1 to 400, and with the £400 of real money received for rent redeemed the £400 of representative money expressed by the "Meat Market Notes." At the end of ten years all the notes were redeemed through the application of the ten years' rental. In this way, they built a very good Market-house without paying any interest on borrowed money, and without injuring any one. In the course of a few years many other undertakings were constructed by similar means.

It is also said that one of the first docks constructed on the banks of the Mersey in Liverpool, was made in the same manner. Labour notes were issued which circulated all through the town, as money does, and they were redeemed out of the dock dues of the first few years.

Now it is very commonly thought that Credit only transfers existing commodities, but this is an utter delusion. Credit is purchasing power, and may be used to purchase Labour as well as commodities, and that labour may be employed in forming or creating new products, as well as in transferring those already in existence. I have thus shown how the Present Values of Future Profits may be used to produce all the effects of money.

Capital. There is still one word whose meaning I must clear up. The aphorism that Credit is Capital sometimes seems to drive some

persons out of their senses. Now it has been seen that Credits or Debts (active) are goods and chattels, vendible commodities, merchandise; therefore, as all modern Economists admit, are Wealth. But how can they be used as Capital? This depends on the meaning of Capital.

Adam Smith's use of the word Capital strikingly exemplifies the defect of his definitions. He enumerates as Capital (1) Material things, (2) Personal qualities, (3) Abstract Rights, such as Bank Notes, Bills of Exchange, etc. Now these abstract Rights are all Credits. Thus Smith expressly includes circulating Credits or Debts under the term Capital.

Now, when we are told that all these things are Capital, we have no more notion of what Capital is than if we were told that they are ABRACADABRA. We do not want an ENUMERATION of what things are Capital, but we want a DEFINITION of what Capital is. The word Capital is derived from the Latin *Caput*, **Capital and Profit.** which means the source of a spring.

or the root of a plant, *i.e.*, the source from which any increase flows. Stephen, in his great "Thesaurus," thus defines the word: "*Κεφάλαιον*—Caput unde fructus et reditus manat"—"CAPITAL—The source from which any Profit or Revenue flows." So Senior says:—"Economists are agreed that WHATEVER gives a profit is properly termed CAPITAL.

This is a good general Definition; and the "Whatever gives a Profit" must be interpreted in as wide and general a sense as the "Anything whose Value can be measured in money" is in the definition of Wealth.

The definition of Capital is, **Definition of Capital.** therefore, "Capital in any Economic Quantity used for the purpose of Profit"; and any Economic Quantity whatever may be used as Capital.

Aristotle pointed out long ago that any Economic Quantity whatever may be used in two different ways (1) The proprietor may use it for his own personal enjoyment; (2) He may trade with it: *i.e.*, he may use it so as to produce a profit.

Thus if a person has a sum of money and he expend it on his own personal gratification or household expenses, the money is not used as Capital.

But if he lends it out at interest, or if he buys goods with it for the purpose of selling them again with a profit,

or if he purchases labour to be employed in producing commodities to be sold at a profit, or if he buys into the funds, or the shares of any commercial company, then he uses his money as Capital; and the goods are also Capital, because he intends to sell them at a profit; and the funds and the shares are also Capital, because they produce him an annual revenue.

Take a very simple example. **Instances of Investment.** Suppose a trader buys goods for £100 and sells them for £125. The trader expects interest on the money he lays out as working Capital. At the end of the operation he is £20 better off than he was at the beginning. He has made a profit of £20. In this case he has made a profit by trading with the realised proceeds of the past.

But suppose a merchant has "Credit," that is, that he is able to buy goods, not with ready money, but by giving his promise to pay at a future time. As the payment is deferred, and there is always some risk of failure in payment, the price in Credit is always higher than the price in money.

Suppose the Credit price of the goods is £105; then, as before, the trader sells the goods for £125. At the agreed upon time he discharges his Debt of £105 and he has a profit of £20. That is, he is better off by £20 at the end of the operation than he was at the beginning; and thus he has used his Credit as Capital. If a man trades with money he makes Capital of the realised profits of the *past*: if he trades with Credit he makes Capital of the expected profits of the *future*.

The following is a brief sketch of the history of the Theory of Credit.

History of the Theory of Credit. Demosthenes, about 350 B.C., first, as far as we are aware, perceived and declared that Credit is Wealth and Capital. But Concrete Practice has always preceded Abstract Theory. The Romans invented book-keeping, and the business which in modern language is technically termed Banking. The Roman bankers invented Cheques and Bills of Exchange; and the Roman Jurists elaborated the great juridical Theory of Credit.

When the practice of writing became general at Rome, a very strict custom or law grew up. The possessions of a family belonged to the family as a whole. But the *Dominus*, or head of the family, alone exercised all rights

over it. It was therefore established that every *Dominus*, or head of a house, should keep a great family ledger as strict and exact as those of a modern banker. In this every incident of his life was recorded. In this he was obliged to enter all sums of money borrowed and lent; all trade profits; all his revenues and profits, his outgoings and expenses of every description. These family ledgers were the only legal evidence of debt among Roman citizens, receivable in Courts of Justice; and it was from these family ledgers that the whole of the modern system of book-keeping and Credit has been developed. The *Dominus* was obliged to swear to the truth of his books before the censors every five years; and they were laid up in the archives of the family to preserve a record of how each successive *Dominus* had administered the property of the Family.

Family Ledgers of
the Romans.

Some of the elementary principles of Credit are set forth in the Institutes of Gaius, which was the text-book for students at law from the age of the Antonines till Justinian.

Gaius.

But the jurists Ulpian, Modestinus, Paulus, Javolenus, and Papinian, the greatest jurists the world ever saw, elaborated the great Juridical Theory of Credit, which, however, was incomplete on some points. From the emphatic way in which certain elementary principles are laid down by these jurists, it is quite clear that there were silly persons at Rome who chattered about Credit just as there are at the present day. It is well known that the immortal legacy which the Romans have left to the world is the creation of the Science of Jurisprudence; and the Juridical Theory of Credit is the very flower of Roman Jurisprudence. The principles of Credit elaborated by these great Jurists were incorporated in the Pandects of Justinian and in the Basilica, and have been the Mercantile Law of Europe ever since. They are contained in every Continental text-book of Jurisprudence, but on this subject English text-books are lamentably deficient.

Other Roman Jurists.

The doctrines of the Roman Jurists were, however, inadequate for the complete Theory of Credit: as they chiefly regarded the subject from the Creditor's side, and only very slightly from the Debtor's side. But, in

Their Doctrines
Inadequate.

every Obligation, there are two sides—the Creditor's or the active or positive side, and the Debtor's or the passive or negative side.

Debts as Negative Quantities.

Accordingly, for the last 150 years, from the days of Maclaurin at least, mathematicians have been in the habit of terming Debts **NEGATIVE QUANTITIES**. But very few have given any explanation of what they mean by terming a Debt a Negative Quantity, and those who have done so, from a want of knowledge of the principles of Mercantile Law and practical business, have entirely failed in giving an explanation which can be received as suitable for Economic Science.

If the subject had been handled by mathematicians who were well trained in Mercantile Law and practical business, there never would have been the slightest difficulty. But, unfortunately, it has been treated by a series of literary and mathematical writers who were entirely deficient in the necessary knowledge; and they have fallen into a mass of errors, which are fully provided for in the Digest, and in every Continental treatise on Jurisprudence.

By applying the principles of the great modern theory of algebraical signs, combined with the subtlest and most abstruse principles of Mercantile business, I have demonstrated the Theory of Credit simultaneously from the Creditor's side and the Debtor's side.

One difficulty, however, the Roman Jurists were unable to solve, and for many centuries it was regarded as insoluble. It was exactly analogous to the doctrine in algebra that $- \times - = + \times +$. And by applying this principle of philosophical algebra, which has only been completely understood by mathematicians themselves and introduced into the common text-books within the last sixty years, I, in 1888, at last succeeded in obtaining a satisfactory solution of the difficulty. So the Theory of Credit is now absolutely complete. Thus, from about the year 350 B.C. to 1888 A.D. it has taken 2,238 years to bring the Theory of Credit to absolute perfection.

I now leave it to your judgment whether it is fit to entrust the teaching of such a subject to literary dreamers, who have not the slightest knowledge of the simplest principles of Mercantile Law, have not the slightest knowledge of practical business, and have not the

faintest idea of applying the principles of modern algebra to the phenomena of Commerce.

I now come to the most subtle and complex question in Economics ; **The Position of a Debtor in an Obligation.** the great Serbonian bog in which multitudes of literary and mathematical writers, who never had the slightest knowledge of the elementary principles of Mercantile Law, have been engulfed.

Lay writers are now generally coming to recognize that if a person possesses a bill or note of £1,000 on a solvent person it is wealth. Oh ! but, they say, if it is Wealth, or a Positive Quantity, and to be added to the other possessions of the Creditor, it is a Negative Quantity and to be subtracted from the possession of the Debtor ; so that, upon the whole, it is nothing.

Suppose a merchant has bought goods and paid for them by a bill, is he "in debt" at the present time ? And is that debt to be subtracted from his present possessions ? **When does Indebtedness commence ?**

Now I have shown you that a Debt (passive) is nothing whatever but an abstract personal duty to pay money. And therefore until that duty to pay has arrived there is no debt. Please to fix in your minds that it is a maxim of English Jurisprudence that, if a person has only the duty to pay at a future fixed time, he is not "in debt" at the present time. Thus if a person is bound to pay a sum of money at twelve o'clock on Friday, he is not in debt on Monday or Tuesday or Wednesday or Thursday, or up to 11.59 a.m. on Friday. The Duty to pay or the Debt only comes into existence when the clock has struck twelve.

It is a maxim of English Law that Credit unexpired may be pleaded under the general issue, which means that if a person sues another for a Debt before it has become due, the defendant may reply that he is not "in Debt" at all.

A few examples will make this clear : (1) Suppose a person takes a house or an apartment and agrees to pay the rent quarterly. Suppose the day after he had entered into possession the landlord came and demanded his rent. What would the tenant say ? He would say : "My good friend, Mr. Landlord, I owe you nothing. The bargain is that I am to have the use and enjoyment of this house for three months before the rent becomes

due and payable. My Debt or Duty to pay does not come into existence till then; good morning to you." Would any man of common sense say that because he has to pay a rent three months hence that is any diminution of his balance at his bankers?

Scotch Leases. (2) It is the common custom in Scotland to grant leases to tenants for 19 years and to pay rent half-yearly. The farmer enjoys the use of the farm for intervals of six months before each instalment of rent becomes due. Would any man of common sense contend that a farmer is indebted at the present day for his rent due only at the end of 19 years, and that it is to be subtracted from his present balance at his bankers?

The "National Debt." (3) It is commonly said that this country is indebted to the amount of about £750,000,000. The answer is that this country is not "in Debt" one penny. Does anyone suppose that her Creditors can come and call upon her to pay £750,000,000 on demand? What the country has undertaken to do is to pay an annuity of about £7,000,000 quarterly, and when one quarter's annuity is paid, she is not "in debt" until next quarter-day comes round. The sum of £750,000,000 is merely the Present Value of an infinite series of future payments.

A Case of Conscience. (4.) This principle strongly applies to a case of conscience. Suppose a kind-hearted instructor engages to prepare a student for one of the public services—say, the Indian Civil Service—and agrees on his success to take an obligation, payable five years after date, in payment of his instruction. On entering the service he is called upon to declare whether he is "in debt" or not. He may most properly and conscientiously declare that he is not "in Debt," because he has no sum of money which is payable by him on demand. He is only bound to pay at the end of five years, and it is quite understood on both sides that his obligation to his instructor is to be redeemed out of his future annual salary.

Novation. This case is an example of *Novation*, which will be mentioned further on. When the candidate has won his appointment in the Indian Service, he is no doubt "in Debt" to his instructors, because he is liable to pay on demand. But if the instructor agrees to take an Obligation payable

five years after date, that Obligation pays, discharges and extinguishes the debt payable on demand, and no new debt arises until the obligation becomes due. The release of the debt payable on demand is the consideration for the Obligation payable five years after date.

The importance of the consideration consists in this, that it is very commonly supposed that when a person has to make a future payment, the sum due is to be *subtracted* from his *present* property, and is a diminution of it. It is usual to denote Debts by the Negative Sign —; and, according to this view, if a person possessed £100 and was bound to pay £30 three months hence, his property would be represented by £100 — £30, which would mean that his property was only £70. But such an idea is wholly erroneous.

Present Property and
Future Duty.

The Debtor has the full property in his £100. He may do with it exactly as he pleases, and his Creditors have no power to prevent him. His Duty to pay has no present existence. It is no *subtraction* from his *present* property. The expression is not to be read as if his property were only £70. The debt is a mere abstract personal Duty; and an abstract personal duty cannot be subtracted from a material sum of hard money. The expression is to be read in this way. He possesses £100 in money, but coupled with it the duty to pay £30 at some future time. Hence in this case the sign — does not mean *subtraction*. It is a mere *memorandum* that he is bound to buy up a Right of action against himself at some future time. It would be wholly impossible for me to explain the whole of this intricate matter in this place, as it involves the whole theory of the application of the modern theory of Algebraical Signs to the Theory of Credit. But if any one should be desirous to investigate the matter further, I may mention that it is fully explained in my "Credit," p. 242.

It is a fad of literary writers on Economics, like John Stuart Mill, the sect according to whose ideas that mountain of tomfoolery, the Bank Charter Act of 1844, was constructed, and the supporters of that fatal craze Bimetallism, that all Bills of Exchange are ultimately discharged by a payment of money or Bank notes. Such ideas only show that those who utter them have not the faintest knowledge of the elementary principles of Credit or of practical business.

The Medium of
Ultimate Redemption.

Small Traders.

I do not doubt that the small fry of traders, who do not keep a banking account, have to discharge their little bills in money or Bank notes. But with respect to *le haut commerce*, and all traders who keep a banking account, such an idea is utterly erroneous. Among such persons the payment of Bills of Exchange by Money and Bank notes has gone entirely out of use. I do not deny that in a very few isolated instances such a thing may occur. But I would hazard a conjecture that at the present not one Bill of Exchange in 500,000 in London is ever paid in Money or Bank notes. I shall shortly explain to you how Bills of Exchange are really paid at the present day.

Four Methods of Extinguishing an Obligation.

Every Jurist in the world knows perfectly well that there are four methods of extinguishing an Obligation.

These are :—

1. Acceptilation,
2. Payment in Money.
3. Compensation.
4. Novation.

Acceptilation.

I shall say nothing about Acceptilation here. I will only say something in the hope of stirring up inquiring spirits.

When you see it stated that the Bank of England has £16,000,000 of Capital, and that several of the great Joint Stock Banks have a Capital of several millions, I presume that the innocent public supposes that these millions of so-called Capital have been paid up in hard cash. Nevertheless this is an utter delusion. Of course an outsider, who has never had access to the books of a Bank, cannot precisely say how much of its Capital was paid up in hard money. But I will venture to say that not one-half of this seeming Capital was ever paid up in hard money, and that the remainder was created by Acceptilation. I am not going to explain the process; but I should like to address this question to our Professors of Economics—How do Joint Stock Banks increase their Capital by Acceptilation? and I wonder how many of them could give an answer.

Payment of Bills in Money.

With respect to payment in money I need say nothing, except that at the present day it has gone entirely out of use as a means of paying Bills of Exchange. At

the present day, among the upper ranks of merchants and traders, Bills of Exchange are almost exclusively paid by *Compensation* and *Novation*.

When two persons are indebted to each other in exactly equal amounts and due and payable at the same time, each may claim that the other shall accept the debt due from him in payment of the debt due to him. That is, they exchange debts and then both debts are extinguished. Each debt is equivalent to a payment in money, and neither can claim payment in money from the other. Each debt is money with respect to the other. This exchange of equal debts which mutually cancel and extinguish each other is termed **COMPENSATION**.

Compensation.

This method of extinguishing debts without the use of coin was formerly, before the institution of Banks, in very extensive use on the Continent. Every three months, there were great fairs held at the principal cities—Lyons, Nuremberg, Antwerp, and many others. The continental merchants, instead of making their bills payable at their own houses, where they would have had to keep large quantities of cash to meet them, made them payable at the great fairs. On a certain day of the fair, they met and exchanged their acceptances, which were thus mutually cancelled and extinguished. Boisguillebert, the morning star of French Economics, says that at the fair of Lyons, 80,000,000 of merchants' bills were discharged by *Compensation*, without the use of a single coin. And this might have been done if the bills had been 800, or 8,000 millions. So long as the reciprocal debts exactly balance, no matter what their actual amount is, there is no use for any coin. This was one of the cases which I put before the Gold and Silver Commission, who were rather startled by my statement that there is no definite and positive ratio between Money and Credit. All depends on the organization of Credit; the more highly organized the system of Credit the less use is there for coin.

NOVATION.—Novation is where one Obligation is used to cancel and extinguish a preceding one.

Novation.

There are two forms of *Novation*.

1. Where a new obligation is created to cancel and extinguish a preceding one. Thus suppose a person owes money payable on demand, and his Creditor agrees to

accept a note from him payable in three months, that new note cancels and extinguishes the debt payable on demand, and the extinction and release from the debt payable on demand is the consideration for the new note, and no debt arises until the note becomes due and payable.

2. Where a person owes a debt to another and he transfers to his Creditor a debt due to him from someone else. If the Creditor accepts this debt it cancels and extinguishes the debt due to him from his own debtor.

Suppose a person goes into a shop and buys goods to the value of £5. He tenders in payment of them a Bank note for £5. Now that Bank note is a debt due to him from the banker. If the shopkeeper agrees to receive the note, it is payment of his debt. The customer's debt is cancelled and extinguished, and the shopkeeper becomes Creditor of the banker.

Thus the Digest says:—" *Verbum exactæ pecuniæ non solum ad solutionem referendum est, sed etiam ad delegationem*; and the Basilica — "ῥῆμα τῶν ἀπαιτηθέντων χρημάτων οὐ μόνον εἰς καταβολὴν ἀναφέρεσθαι δεῖ, ἀλλὰ καὶ ἐς ἔκταξιν"—"The word payment includes not only a payment in money, but also the Transfer of a Credit."

Now, at the present day, payment of bills is almost exclusively made by *Compensation* and *Novation*. I shall shortly show you what a colossal part *Novation* plays in paying and extinguishing bills, by explaining to you the action of the Clearing House.

Credit is a Marketable Commodity. A Credit, or a Right of action, or a Debt, then, as I have endeavoured to show you, is the name of a certain species of marketable commodity, or merchandise, and is bought and sold just like any other merchandise, such as gold, jewellery, a horse, a quarter of corn, timber, or any other. In this great mercantile country, Credit or Debts are bought and sold to the amount of thousands of millions every day. And this Credit, or Debt, may either be unwritten or written, and it may be bought and sold with perfect facility in either form. An abstract debt between two persons is called "Personal Credit." It is called in Roman Law a *Res Incorporalis*, and in English Law an Incorporeal commodity. It can neither be seen nor touched, nor handled; but it may be bought and sold and transferred from person to person. Suppose A has a debt against B, and wishes to transfer it to C. The three parties meet together. A

tells B he wishes to transfer his Credit to C. B gives his consent. Then A's right of action is transferred to C as if it were a Bank Note. B is released from his debt to A and becomes Debtor to C.

So a vast mass of debts are recorded in the books of bankers and traders. Such debts are termed "Book Credits," and these may be transferred by word of mouth with perfect facility. But a much more convenient way is to record the debt on some material such as paper, and it is then called "Paper Credit." The debt then becomes a material commodity, and may be transferred from hand to hand just like a piece of money, and may circulate in commerce, and produce all the effects of money, until it is paid off and extinguished. You must, therefore, observe that the whole amount of Debts, personal, book, and paper, constitute a vast mass of exchangeable property which has exactly the same effect on production, circulation, and prices, as an equal amount of gold.

Book and Paper
Credits.

A host of literary dreamers and high College dignitaries, have assailed my exposition of Credit. They ridicule the notion of a Bank Note or a Bill of Exchange being independent exchangeable merchandise, because, they say, that a Bank note or bill is merely the title to a sum of money, and therefore cannot be separate property from it. If they broached this doctrine before a Court of Law, or the pupil room of any barrister in the Temple, they would be saluted with shouts of laughter. The very first thing that is inculcated on every student of mercantile law is that a bill or note is *not* the title to any specific sum of money. It is a mere abstract charge against a *person*. When a trader accepts a bill, he need not have a penny of money. All he engages to do is, on the day the bill becomes due, to be in possession of money and to buy up the Right of action against himself on that day. A title to a specific sum of money is *not* a bill at all, and is not Credit. A note or bill is specially called a Credit because the person who accepts it in payment of goods, merely believes, or has confidence, that the debtor on it can redeem it in money on the day it is due and payable. It is called a Credit for the very reason that it is *not* a title to any specific money. A title to specific money and a mere abstract charge against a person are two vastly different things. The one is not

Hostile Criticism.

a separate property from the money, and cannot circulate by itself. The other is absolutely separated from any money and circulates by itself as an independent article of merchandise, and forms an article of property or merchandise by itself. In every operation of Credit whatever a new property is created or called into existence. It has value just for the same reason that everything else has value, because at the proper time it can be exchanged for money.

**Credit in Relation to the
Definition of Wealth.**

We now see the supreme importance of adopting the unanimous doctrine of the ancients, that Exchangeability is the sole essence and principle of Wealth. It is this fundamental concept which clears up all the contradictions and confusion with which the current text-books which are thrust before unfortunate students of Economics are loaded.

The Age of Credit.

Money and Credit in all its forms, both written and unwritten, constitute the Circulating Medium, or Currency, and the measure of prices. We have long passed through the ages of Gold and Silver. We are now in the age of Credit or Paper. Gold and Silver are now only used in small daily and retail transactions, to serve as pocket money. All operations in commerce and trade, with a few infinitesimal exceptions, are now carried on by the Creation, the Circulation and the Extinction of Rights of Action, Credits or Debts. The only use of Gold now in commerce is for banks to keep such strong reserves of Gold as to inspire the public with confidence that they can pay the Credits or Debts in Gold on demand if required. It is a known fact that, in this country, Gold and Silver do not form so much as one per cent. of the Circulating Medium or Currency. And, as you will see in any work on Economics, the profits of trading on Credit are just the same as by trading with money, you will see that the great American jurist, Daniel Webster, well said:—"Credit has done more a thousand times, to enrich nations, than all the mines of all the world."

Banking.

I now come to explain to you the nature and organization of the colossal system of Banking. When every paper boasts its Financial Editor, whose constant talk is about Banking, and vast numbers of persons give us their opinions about Banking, one might at least suppose they

know what they are talking about. But I have now to show you that all the common notions derived, I presume, from that obsolete book, *Gilbart on Banking*, are utterly erroneous.

If we take up Gilbart's book we find it stated:— *Gilbart on Banking.*

(1.) That the word Bank comes from the Italian word *Banco*, which means a Bench, because it is alleged that the Italian money dealers, or money changers, kept their money on a Bench whence they were said to have been called *Banchieri*.

(2.) That the business of a banker consists in dealing in Money: or in acting as an intermediate agent between persons who want to lend money and those who want to borrow money.

(3.) That the profits of a banker consist in the difference between the interest he pays for the money he borrows and the interest he charges for the money he lends.

All these notions, however, proceeding from apparently high authority, are entirely erroneous. The Italian money changers, as such, were never called *Banchieri* in the middle ages; nor are persons whose sole business is money changing ever called bankers in any language.

The word Bank originated in this way. In 1171, the City of Venice was at war with the Empires of both the East and the West. Its finances were in a state of great disorder; and the Great Council levied a forced loan of one per cent. on the property of all its citizens and promised them interest at the rate of five per cent. Commissioners were appointed to manage the loan. Such loans have several names in Italian, but the most usual one is *Monte* or joint stock fund. This first loan was called the *Monte Vecchio*. Subsequently two similar loans were contracted, and called the *Monte Nuovo* and the *Monte Nuovissimo*. In exchange for the money, which became the absolute property of the Government, to be employed for public purposes, the citizens received Stock Certificates, or CREDITS, which they might transfer to anyone else. And the Commissioners kept an office for the transfer of the stock and the payment of the dividends.

At this time, the Germans were masters of a great part of Italy and the German word BANCK, meaning a heap, or mound, was Italianized into BANCO, and came

to be used as synonymous with *Monte*. Thus the public loans were called indifferently *Monti*, or *Banchi*.

It was this office which multitudes of writers have supposed was the famous Bank of Venice. But this is a complete mistake. It was in no sense a Bank in the modern sense of the word. It was simply the National Debt Office, similar to the National Debt Office of the Bank of England. It was the origin of the Funding system.

Thus in the "*Volpone*" of Ben Jonson, the scene of which is laid in Venice, Volpone says:—"I turn no monies in the public BANK," meaning, "I do not dabble in the Venetian Funds." So an English writer, Benbrigge, in 1646, speaks of the "three Bankes" at Venice, meaning the three public loans or *Monti*. In an Italian dictionary, published in 1659, it says:—"Monte, a standing *Bank* or *Mount* of money." And Blackstone says:—"At Florence in 1344 Government owed £60,000, and, being unable to pay it, formed the principal into an aggregate sum called metaphorically a *Mount* or *Bank*." The Italian Economists invariably use the words *Monte* and *Banco* as synonymous. This was the meaning of Bank when it was first introduced into English. Thus Bacon says:—"Let it be no Bank or common stock." When the word Bank was introduced into our American colonies, before the revolutionary war, Professor Sumner says that it only meant a batch of paper money.

These instances are enough to place before you on the present occasion, but I have given a great many more in my "*Credit*," p. 577 *et seq.* Thus to "*Bank*" as a technical term in business means to purchase money and to issue "*Credit*" in exchange for it.

Nature of Banking. Equally great misconception prevails as to the nature of the business of "*Banking*." Gilbert says:—"A banker is a dealer in Capital, or more properly a dealer in Money. He is an intermediate party between the borrower and the lender. He borrows of one party and lends to another."

Money Scriveners. Such an idea is entirely erroneous. In former times there were many persons who acted as intermediaries between persons who wanted to lend and others who wanted to borrow money. They were called Money Scriveners. The father of John Milton was a Money Scrivener. But no one ever called a Money Scrivener a *Banker*.

At the present day many firms of solicitors act as intermediaries between persons who wish to lend and others who want to borrow. They may have some clients who wish to lend and other clients who wish to borrow; and they act as agents between them. They receive a commission on the sums which pass through their hands. But no one ever called solicitors who transact such business "Bankers," which shows that there is an essential distinction between the business of Money Scriveners and such solicitors and the business of "Bankers."

Solicitors who
Negotiate Loans.

I have now to explain the nature of banking business. Suppose customers pay in £10,000 to their account. They cede the absolute property in the money to the banker. It is a *Mutuum* or *Creditum*. The banker buys the money from his customers, and in exchange for it he gives them an equal amount of Credit in his books, that is, he creates Rights of action against himself to an equal amount, and giving his customers the right to demand back an equal amount of money at any time they please, and also the right to transfer their Rights of action to anyone else they please, exactly as if they were money. The banker also agrees to pay the transferee the same as if he were his own customer. This Right of Action, Credit, or Debt entered in the banker's books, is in banking language technically termed a DEPOSIT.

Banking as a Business.

After such an operation his accounts would stand thus:—

LIABILITIES.

ASSETS.

Deposits ... £10,000		Cash ... £10,000
----------------------	--	------------------

Now, though his customers have Rights of action against the banker to demand back an equal sum of money to what they have paid in, yet persons would not pay money to their banker if they meant to draw it out again immediately. Nevertheless, some will want to draw out part of their funds, but others will probably pay in an equal sum. Observation showed me that in ordinary and quiet times a banker's balance will seldom differ by more than one thirty sixth part from day to day.

The banker's cash is, therefore, like a column of gold with a slight ripple on the surface; and, if he retains one-tenth in cash to meet any demands upon him, he has

£9,000 to trade with and make a profit by; and it is just in the method in which bankers trade that so much misconception exists.

It is commonly supposed that when a banker has £9,000 to trade with he employs it in purchasing Bills of Exchange to that amount, and so makes a profit on the £9,000; but that is a complete misconception of the nature of "banking." A "*banker*" never buys Bills of Exchange with money. That is the business of a money lender or a bill discounter. The way in which a banker trades is this. He sees that £1,000 in cash is sufficient to support liabilities to the amount of £10,000 in Credit. Consequently he argues that £10,000 in cash will be sufficient to support several times that amount in Credit.

One of the most eligible methods of trading for a banker is to buy or discount good commercial bills. And he buys these bills exactly in the same way as he bought the cash, that is, by creating Credits in his books, or Debts, or Rights of action against himself to the amount of the bills—deducting at the same time the Interest, or Profit, agreed upon, which is called the Discount.

A "banker," therefore, invariably buys a Bill of Exchange with his own Credit, and never with cash—exactly in the same way as he bought the cash. He buys a Right of action, payable at a future time, by creating and issuing a Right of action payable on demand, and this right of action, or Credit, is also in banking language termed a DEPOSIT.

Suppose the banker buys £40,000 of bills at three months, and that the agreed upon profit is 4 per cent. Then the sum to be retained upon these bills is £400. Consequently, in exchange for bills to the amount of £40,000 he would create Rights of action, Credits, Debts—technically termed Deposits—to the amount of £39,600.

Hence, just after discounting these bills, and before his customers began to operate upon them, his accounts would stand thus:—

LIABILITIES.			ASSETS.		
Deposits	£49,600	Cash	£10,000
			Bills	40,000
		<hr/>			<hr/>
		£49,600			£50,000

and the balance of £400 would be his own profit and property.

By this process, the banker has added £39,600 in Credit to the previously existing cash, and his profit is clear. He has not gained 4 per cent. on the £9,000 in cash, but 4 per cent. on the £40,000 of bills he has bought.

This is what the business of Banking essentially consists in, and you will see at once that the idea that a banker is merely an intermediate agent between persons who want to lend and those who want to borrow is entirely erroneous; and also that Gilbert's doctrine, that a banker's profits consist merely in the difference between the interest he pays for the money he borrows and the interest he charges for lending that money out, is also erroneous. A banker's profits consist in the interest he receives for the amount of his Credit he can keep in circulation over and above the cash he keeps in reserve.

The very essence and meaning of the word to "Bank" is to issue Credit, which is intended to circulate and perform all the functions of money. The essence of Banking consists so exclusively in issuing Credit, that Lord Overstone and Mr. G. Warde Norman termed the issuing of Bills of Exchange by merchants "banking operations." The Foreign Exchanges consist of buying and selling bullion and bills of exchange. Dealings in bullion are termed Bullion operations, and dealings in Bills of Exchange are termed Banking operations. Near the Royal Exchange you see traders described as "Money Changers and Foreign Bankers," which means not only that they exchange foreign monies, but that they also grant bills on their correspondents abroad.

The true definition of a banker is this:—*"a Banker is a trader whose business consists in buying money and Rights of action, Credits, or Debts payable at a future date by issuing in exchange for them, Rights of action, Credits or Debts payable on demand."*

Definition of
"Banker."

A Bank is, therefore, not an office for "borrowing" and "lending" money, it is a MANUFACTORY of

A Bank a Factory
of Credit.

CREDIT: as Mr. Cazenove well said: "It is the Banking Credits which are the loanable Capital"; and, as Bishop Berkeley said: "A Bank is a Gold Mine."

I may also remark on a common misconception. If you look at the City articles you always see the "Money

Market" spoken of; and, of course, the lay public believes that it is real money which is "lent" as it is termed. This is a pure error. It is simply Credit which is bought and sold. It would greatly conduce to the clear understanding of the subject if the City editors would discontinue using the term "Money Market" and call it the "Credit Market."

I have no space to give more than these remarks to the colossal business of banking. But they only touch the fringe of the subject. If you care to study the mechanism and effects of the various kinds of banking, I can only refer you to my "Credit," p. 572, where you will find the whole details set forth.

Deposit. I must now say a few words on the meaning of *Deposit*, which is utterly misunderstood by most writers.

Most persons suppose that a Deposit is the money placed in a bank and held in reserve by a banker as part of his assets. But such an idea is wholly erroneous. The money paid into a bank by its customers is not a *Depositum*, but a *Mutuum* or *Creditum*.

The word *Depositum* is one of that class of Latin words which mean a material commodity, but which in the technical language of modern commerce mean nothing but a Right of action.

A *Depositum* in Roman Law means anything which is placed in the gratuitous charge or custody of some person for the sole purpose of safe keeping, without the property in it passing to him, or his being allowed to use it in any way for his own advantage, or even being allowed to retain it as a lien for a debt due to him.

It is part of the duty of a London banker to take charge of his customers' plate, jewellery, and securities, if required to do so. This plate, jewellery and securities so committed to the charge of the banker for pure safe custody is what in Roman Law is termed a *Depositum*.

The banker acquires no property in such a *Depositum*. He can make no use of it for his own advantage. If he did so he would be guilty of felony. He receives no remuneration for keeping it; and he has no lien on it if his customer becomes indebted to him.

So if a customer tied up a sum of money in a bag, and placed it in the custody of his banker for pure safe custody, it would be a *Depositum*, and the banker would

be bound to redeliver the specific bag of money to him on demand, untouched. It is said that, in the great American crisis of 1893, vast numbers of the customers of the banks drew their balances in gold as *Credita*, and replaced them in their bankers' hands as *Deposita*, in which case the bankers could not touch them.

It is almost universally supposed by lay writers that when a customer pays in money to his account with his banker that it is a DEPOSIT, and that the "Deposits" of a bank are the cash held in reserve. This however is entirely erroneous.

When a customer, in the ordinary way, pays in money to his account, he loses all property in it. It becomes the absolute property of the banker to use in any way for his own advantage. Such money, therefore, is not a *Depositum*. It is a *Mutuum* or *Creditum*.

In exchange for this money, the banker creates an equal sum in Credit; that is, he issues a Right of action to him. And it is this entry of Credit, or Right of action, in his customer's favour, which in the technical language of modern banking is termed a DEPOSIT. That is the banker buys the money by creating a DEPOSIT.

So when a banker discounts a bill from a customer. He buys a Right of action from him by creating a Right of action, or Credit, payable on demand. And this Credit is also termed a DEPOSIT. A Deposit is usually thought to be an asset of the banker. But is not so. The Money and the bills he has bought are the banker's assets. His Deposits are his liabilities, as anyone may see by looking at the weekly returns of the Bank of England. A banker's Deposits are simply the liabilities he has created to purchase his assets. A Deposit is simply a Banking Credit.

It is now seen how CREDIT is CAPITAL to a banker. For what is the commodity which a banker deals in and makes a profit by? He first of all offers to buy any gold which anyone is willing to sell to him. And what is the commodity with which he buys the gold? what does he give in exchange for it? His own CREDIT.

How Credit is Capital
to a Banker.

He then gives notice that he is ready to buy good Commercial Debts—which are Credits or Rights of action—which anyone has got to sell. And with what does he buy these Credits, Debts, or Rights of action?

again with nothing but his own Credit—by creating Rights of action against himself.

The banker charges exactly the same price for his Credit as if it were Money. Hence he makes exactly the same profit by selling his Credit as if he were selling Money.

Now we have seen that anything which gives a profit is Capital. Hence as a banker's Credit produces him exactly the same profit as money would, it is evident that his Credit is Capital to him just as much as money is.

Again, Credits, Debts, or Rights of action are goods, chattels, commodities, merchandise. Under the term Circulating Capital, Smith expressly includes the goods or commodities in shops. The trader buys them at a lower price from one person, and sells them at a higher price to another person, and so makes a profit by them. Thus the goods in the shop are Capital to him. Smith also expressly includes Bank Notes, or Banking Credits, and Bills of Exchange, under the term Circulating Capital.

**Profits on Purchase
and Sale of Debts.**

A banker buys the goods or commodities termed Credits, Debts, or Rights of action from one person, his own customer, at a discount or lower price than their face value, and sells them at a higher price, *i.e.*, their face value to another person, the Acceptor or Debtor. The debt the banker buys is increasing in value every day from the time he buys it until it is paid off. These goods or commodities, termed Debts, in the portfolio of a banker, produce him a profit exactly in the same manner as the goods, commodities, or merchandise in the shop produces profits to a trader.

Hence the bills in the portfolio of a banker are CIRCULATING CAPITAL exactly in the same way as the goods, commodities, or merchandise in a shop are CIRCULATING CAPITAL.

**How Bills of Exchange
are Paid.**

I have said above that it is an almost universal idea that all Bills of Exchange are paid in Money or Bank notes. But this is an utter delusion. I have now to explain how the vast majority of Bills are paid.

All merchants and traders buy goods on Credit, and they also sell them on Credit. Hence they are not only indebted on their own acceptances to those from whom they have bought the goods, but they hold the acceptances of those to whom they have sold goods.

Merchants and traders who keep a banker do not make their bills payable at their own houses but at their bankers'.

A merchant knows when his own acceptances are due, and if he has not sufficient funds at his credit to meet them he has only two methods of providing for them. He must either sell his goods in the market, or he must discount the acceptances he holds with his banker. The latter, of course, is the preferable plan.

The merchant of course makes his own acceptances payable at his bankers; consequently, on the day they mature and become payable they are simply cheques. And the whole mass of Bills and Cheques pass through the Clearing House as we shall show in describing the operations there, and the whole transactions are settled by pure transfers of Credit, without the use of a single Coin or Bank Note.

Hence in our present highly organized system of Credit, Bills of Exchange are not paid in Money or Bank notes at all, except perhaps in a very few isolated instances—but they are paid by the constant creation of BANKING CREDITS. And these Banking Credits are now for all practical purposes the CURRENT COIN of the realm.

Hence in our present system, the constant creation of Banking Credits is a matter of vital necessity. If the London bankers were suddenly to give notice that, next day, they would stop discounting, the result would be that 19 out of 20 merchants would be ruined.

Necessity of Banking Credits to Modern Commerce.

But, more than that. The merchants would, of course, exhaust all their means to maintain themselves, and they would instantly draw their balances. Thus the bankers would draw upon themselves a RUN for GOLD.

It is perfectly well known to all bankers that "*An Excessive Restriction OF CREDIT causes and produces a RUN for GOLD.*" And thus bankers and merchants would all come down in one universal crash. And this is a consideration of the first importance in judging of the working of the Bank Charter Act of 1844, which however is beyond our present limits.

Effect of Restriction of Credit.

The constant and uninterrupted creation of Banking Credits is an indispensable necessity to maintain the

existence both of merchants and bankers ; and the only thing to be considered is under what conditions they are to be created.

The Clearing House. I now come to speak of an institution of which you have all heard, but of whose organization very few people have any idea. It plays a most important part in the system of Credit, and is called the CLEARING HOUSE.

What it is not. It is usually stated that the Clearing House is an example of the principle of *Compensation*, like that effected by the foreign merchants at the continental fairs. In foreign treatises the Clearing House is called a *Maison de Compensation* or of *Liquidation*. But this is a complete error.

If any number of customers of the same Bank have transactions among themselves, and give each other Cheques on their accounts, any number of transactions may be settled by mere transfers of Credit from one account to another without a single coin being required, so long as the receiver of the Cheque does not draw out the money. And when the Credit is transferred from one account to the other it is equivalent in all respects to a payment in money. Such transfers are *Novations*.

What it is. The clearing system is a device by which all the Banks which join in it are formed, as it were, into one huge Banking institution for the purpose of transferring Credits from one Bank to another without the use of coin, just in the same way as Credits are transferred from one account to another in the same Bank without the use of coin. The Clearing House is, therefore, not a *Maison de Compensation* or *Liquidation*, but it is a *Maison de Novation*.

Every banker has every morning claims on behalf of his customers against his neighbours, and they have claims on behalf of their customers against him. These claims are called Bankers' charges. Formerly it was the custom for every banker to send out his clerks the first thing in the morning to collect these charges, which had to be paid in money or bank notes. Having collected these charges, he credited his customers with the sums due to them. Now when the Banker had paid the charges against him, there was, of course, so much credit extinguished. The money and bank notes collected by the banker became his actual property, but he was

obliged to create an equal amount of Credit on behalf of his own customers ; so that an exactly equal amount of Credit was recreated to what had been extinguished. Thus the final result was that there was exactly the same amount of Credit in existence.

But each of his neighbours had also claims on behalf of their customers against him. Consequently every banker was obliged to keep a large amount of money and bank notes to meet these claims. Consequently a very large amount of money and bank notes had to be retained for the sole purpose of meeting these bankers' charges : it was simply transferred and retransferred from bank to bank ; it never got into general circulation, so as to affect business or prices ; and it could be made no further use of.

To remedy this inconvenience, an ingenious method was devised, it is said, by the banks at Naples, in the 16th century. They instituted a central chamber, to which each sent a clerk. These clerks exchanged their different claims against each other and paid only the difference in money. Clearing at Naples,

By this means the Credits were readjusted among the different customers' accounts just as easily as before ; and a large amount of money and notes were set free for the purpose of circulation and commerce, and were in fact for all practical purposes equivalent to so much increase of Capital to the banks and the country.

This system was first adopted in this country by the Edinburgh banks. and Edinburgh. And I have now to show that no permanent extinction of Credit takes place, as in *Compensation*. The final result is only a Transfer of Credit, that is, a *Novation*.

I will take the case of Banks which issue notes. Suppose a customer of the Commercial Bank has £100 in notes of the Royal Bank paid to him. He is then Creditor of the Royal Bank. Clearing is Novation. He pays these notes into his account with the Commercial Bank. He desires the Commercial Bank, as his agents, to collect the proceeds of these notes from the Royal Bank, and to place the amount to his credit.

Suppose, in a similar way, a customer of the Royal Bank has £100 in notes of the Commercial Bank paid to him. Then he is Creditor of the Commercial Bank. He

pays these notes into his account with the Royal Bank, and constitutes them his agents to collect the proceeds from the Commercial Bank and place them to his Credit.

Then each Bank is Debtor to the customer of the other.

The full way of proceeding would be for each Bank to send a clerk to the other to collect the notes in money. Each Bank then having obtained payment of the notes in money would place the amount to the Credit of its customer, and put the money which would become its own property into its own till, just as if the customer had paid in the money himself.

It is evident that in this case there is no permanent extinction or diminution of Credit, because by the process each Bank, instead of being debtor to the customer of the other, becomes debtor to its own customer. Thus it is evident that in each case there is a *Novation*, and not a *Compensation*.

The same result may be obtained in a much simpler way.

Let the clerks of the two Banks meet. The clerk of the Commercial Bank says to the clerk of the Royal Bank: "In consideration of your giving up to me the notes held by your customer by which I am debtor to him, and so releasing me from my debt to him, I agree to credit my customer with their amount: and so become debtor to him." This is a *Novation*.

The clerk of the Royal Bank says to the clerk of the Commercial Bank: "In consideration of your giving up to me the notes held by your customer, by which I am debtor to him, and so releasing me from my debt to him, I agree to credit my customer with their amount, and so become debtor to him." This is also a *Novation*.

The clerks of the two Banks then exchange notes, and each Bank having received £100 in its own notes—that is being released from its debt to the customer of the other, which is equivalent to a payment in money—enters the amount to the Credit of its own customer. By this means each Bank, instead of being Debtor to the customer of the other, becomes Debtor to its own customer, and the use of £200 in money is saved. The release of the debt of each Bank to the customer of the other is the consideration for the creation of the debt to its own customer.

No doubt the £100 of notes from each Bank are withdrawn from circulation and replaced in its own till.

Withdrawal of Notes
from Circulation.

But an equal amount of Credit is created and placed to the Credit of each customer, so that upon the whole the quantity of Credit remains the same, and the whole transaction consists of *Novations*.

The reason why the operations of the Continental merchants were Compensations in which both Credits were extinguished, and the operations of the Clearing House are *Novations*, in which new Credits are created, which pay and extinguish the prior ones, but created an equal amount of new Credits, so that the whole amount of Credit remains exactly the same as it was before, is this. In the case of the Continental merchants, they were principals. They were mutually indebted to each other. When, therefore, they exchanged their mutual debts, they were cancelled and extinguished; and no new debts were created to replace them.

The Clearing House and
the old Continental
System.

But in the case of the Clearing House the Banks are not principals: they are only Agents for their customers. Consequently, when they receive their notes from each other, thereby releasing them from the debts to the customer of the other, they are bound to create an equal amount of Credit in favour of their own customer. So that, upon the whole, the amount of Credit remains exactly as it was.

By this ingenious system, Credits are transferred from banks to banks in the London Clearing House to the amount of more than £7,000,000,000 every year, without the use of a single coin. But besides that there is the country Clearing House, and every considerable town in the kingdom has its own Clearing House. By the institution of these Clearing Houses many millions of gold are dispensed with in business. These examples of the use of *Compensation* and *Novation* in extinguishing debts show that there is no positive and definite ratio between Money and Credit, as so many people suppose, but that the more highly the system of Credit is organized, and the more banking habits are developed among the people, the less is the amount of gold which is required as the foundation upon which the whole superstructure rests.

Conclusion. I must now conclude these disjointed remarks. Again I must beg you not to consider that they contain a complete exposition of the mighty system of Credit, but only some salient points in it. I am like Paddy at Donnybrook Fair, with a stout shillelah in his hand, who went round the tents, feeling for bumps in order to give them a thwack. I have simply thrown out some observations which I hope may touch your bumps of inquisitiveness and induce you to prosecute an inquiry into the whole subject.

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TESTIMONIALS.

Judgment of the Court of Exchequer Chamber in the case of *Goodwin v. Roberts* delivered by Lord Chief Justice Cockburn.—(L.R. 10 Exch. 337) :—

“ We find it stated in a Law Tract by Mr. MacLeod, entitled ‘ Specimen of a Digest of the Law of Bills of Exchange,’ printed, as we believe, as a Report to the Government, but which from its research and ability, deserves to be produced in a form calculated to ensure a wider circulation,” &c.

* * The above judgment declares the principles of Credit set forth by the Author to be strictly accurate in every particular, and they are now by **Statute the Law** of the land.

Lord Hatherley.—Mr. H. D. MacLeod was selected by the Commissioners for the Digest of the Law to prepare a Digest of the Law in relation to Bills of Exchange. He performed his task in a manner which showed that he had an extensive and very intelligent knowledge of the Law.

Lord Westbury.—The papers you prepared for the Law Digest Commission proved that you had a profound and comprehensive knowledge of a most important part of Mercantile Law.

Lord Selborne.—You are entirely at liberty to state my belief, founded upon the Specimen Digest of the Law of Bills of Exchange prepared by you for the English Law Digest Commissioners that you are well qualified for the Professorship in Edinburgh which you seek to obtain.

Lord Penzance.—I can truly say that I was very much struck by the ability and learning evinced in the work you did for the Law Digest Commission.

Mr. Justice Stephen.—I read your book before I left town and I admire it very greatly.

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